Finding Opportunity in a Crisis

COVID-19 has disrupted fundraising processes in Southeast Asia, but is also presenting timely opportunities for investment

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The Chinese word for 'crisis' contains the characters 'danger' and 'opportunity,' rightly identifying a crisis as an opportunity. This current pandemic, which is creating global havoc, is no different.

In the past few months, we have seen an increasing number of countries close their borders and put in place varying degrees of restrictions on operating businesses and people movement in general. This has impacted the fundraise process for GPs in many ways. There is no doubt that due diligence will have to continue online via video conferencing and virtual data rooms until travel restrictions are eased, as in-person meetings remain key for new relationships. In that context, most fundraising processes are expected to be delayed by 3-6 months, and probably more for emerging managers.

While some LPs have adopted a wait-and-see approach to fundraising, preferring to preserve cash, many astute LPs have continued to deploy and invest. It is in such times when GPs can invest in companies at more reasonable valuations, or gain access to opportunities that would never have been available in normal times. It is expected that the quality of deal flow will increase and this COVID-19 situation, like previous down markets or crises, will provide the opportunity for fund managers to perform well.

Private Equity Opportunity amid Crisis

The funds that are currently fundraising are going to see attractive opportunities and valuations that would not be possible pre-COVID-19. As entrepreneurs recalibrate their expectations about valuations, the pandemic also weeds out those businesses that are fundamentally weak or have flawed structures. Post-COVID-19, it will not be business as usual. Many affected businesses would have been forced to transform their processes to stay relevant and viable while cities shut down to fight COVID-19.

In this season of lockdown, e-commerce, digital services, healthcare, and logistics businesses have done well. As various Southeast Asian economies recover in the next 12 months, technology-based opportunities will flourish as companies digitalize their work processes and allow more remote working arrangements to become the new norm. With consumers now more accepting toward online learning and even telemedicine, delivery services and increasingly the intermediaries that make the digital lifestyle possible will become more entrenched in this new norm after the world has recovered from COVID-19.

Southeast Asian economies, in particular Indonesia, may have a propensity for higher levels of leverage, both at the operating and shareholder levels. As the economic impact of COVID-19 unfolds, financial stress at either of these levels could yield opportunities for quality assets in several different sectors. Hence, well-capitalized fund managers will be in a better position to invest in the surviving businesses that have proven themselves as the pandemic wanes globally.

Traditionally, Asian private equity fund managers rely less on leverage than their peers in North America and Europe. We expect the gap in performance for funds already deployed to be more or less positive in favor of

Asia, especially if Asian economies rebound faster than the rest of the world.

Expected Emergence of the Private Credit Asset Class

In such times where credit is vital – and credit markets are often inefficient in Asia – private credit funds are gaining traction as deal flow increases. For those funds that are already in the market, interest from LPs is piqued as they look for risk-adjusted returns in uncertain times. While private credit funds are already well developed in North America and Europe, there is room for exponential growth in Asia. With the implementation of Basel III, local and international banks are forced to increase their capital/liquidity ratios and reduce risk-weighted assets. Southeast Asian banks and corporations have turned to new, external sources of private capital and liquidity, such as secured financing, securitization, and regulatory capital CLOs. Furthermore, the imbalance between the growing demand for credit from issuers serving the rising Asian middle class and the shrinking traditional supply of credit will allow increasing amounts of money to be deployed by private credit fund managers.

Selective Approach when Investing in Real Estate

Over the last decade, more money was raised by real estate funds investing in the Southeast Asia region than the combined amount allocated to funds investing in buyout, growth capital, and venture capital strategies. The current crisis will materially impact the performance of unrealized real estate assets even though the real estate strategy was reputed to be characterized by a lower risk.

The Moment Is Now

In the context of low interest rates, private markets in Southeast Asia remain an attractive asset class in 2020/2021 for those investors with a long-term horizon. In particular, two compelling propositions stand out. Firstly, play it quick and safe by investing in private credit where there is huge demand and distributions are often made on a quarterly basis. Alternatively, play it far-sighted and invest in experienced fund managers who will have the next few years to strengthen and value add to their investees.

Capstone Partners

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Michele is responsible for distribution and client origination in Southeast Asia.

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